Office of Chief Counsel
Internal Revenue Service
Memorandum

CC:SB:2:PIT:EFPeduzzi
GL-110970-05

date: July 26, 2005

to: W. Ricky Stiff
Chief, Excise Tax Program

from: Division Counsel
(Small Business/Self-Employed)

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subject: Warrantless Fuel Inspections on Private Property

This responds to your request for advice dated February 16, 2005. This advice should not be cited as precedent.

ISSUES

Whether the propulsion tank of a commercial motor vehicle located on private commercial premises would qualify as "Any fuel storage facility that is not a terminal" as used in Treas. Reg. § 48.4083-1(b)(1)(ii)?

Alternatively, whether the propulsion tank of a commercial motor vehicle located on private commercial premises associated with the commercial trucking industry would qualify as "Any fuel storage facility that is not a terminal" as that phrase is used in Treas. Reg. § 48.4083-1(b)(1)(ii)?

CONCLUSION

We conclude that neither proposed interpretation of Treas. Reg. § 48-4083-1(b)(1)(ii) can be sustained legally or administratively for the following reasons:

(1) [redacted]

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(2) The interpretation does not comport with the plain meaning of the terms "store" and "facility" nor does the legislative history of § 4083(c) support such interpretation.

(3) Such an interpretation would not be consistent with the position taken by

the IRS in Rev. Rul. 69-150, 1969-1 C.B. 286 and in Rev. Rul. 65-153, 1965-1 C.B. 542 which is that fuel in the propulsion tank of a vehicle or piece of equipment is considered to be part of that vehicle or piece of equipment.

DISCUSSION

Constitutional Principles Underpinning Warrantless Fuel Inspections.

The Fourth Amendment bars "unreasonable searches and seizures" and provides that warrants may be issued only upon "probable cause" supported by oath or affirmation, and must "particularly describe" the place to be searched and the persons or things to be seized.

In 1967 the Supreme Court held in the companion cases of Camara v. Municipal Court, 387 U.S. 528 (1967) and See v. City of Seattle, 387 U.S. 541 (1967) that warrantless searches of commercial property were unconstitutional and that an administrative search of a commercial property generally must be supported by a warrant. However, the Court further held that administrative inspection warrants can be issued upon a showing that the intended inspection complied with "reasonable legislative or administrative standards" which is a lower standard than the probable cause needed for criminal warrants.

In 1977, the Supreme Court in G.M. Leasing Corp. v. United States, 429 U.S. 338 (1977) rejected the argument of the government that there exists a broad exception to the Fourth Amendment that allows warrantless intrusions into privacy in the furtherance of the enforcement of the tax laws. Here, the Supreme Court held that a warrantless search of property was per se unreasonable and, as a result, the IRS was required to establish procedures for obtaining writs of entry for entering places where there is an expectation of privacy protected by the Fourth Amendment. Of particular concern to the Court in this case was the discretion of the seizing officer, citing Camara and See. The Supreme Court noted that § 6331 gives the IRS discretion as to what property to seize and therefore could "hardly be called a restraint on discretion." 429 U.S. at 357.

In a line of cases starting with Colonnade Catering Corp. v. United States, 397 U.S. 72 (1970) (inspection of holders of liquor licenses); United States v. Biswell, 406 U.S. 311 (1972) (inspection of gun dealers); Marshall v. Barlow's Inc, 436 U.S. 307 (1978) (inspections of work places subject to OSHA regulations); Donovan v. Dewey, 452 U.S. 594 (1981) (inspections of mines); and culminating in New York v. Burger, 482 U.S. 691 (1987) (inspections of automobile junkyards), the Supreme Court has established a narrow exception to the Fourth Amendment's requirement that a warrant is necessary for a search to take place.

Burger established the rule that if a business is "closely or pervasively regulated" then a warrantless inspection is constitutionally permissible, only as long as three criteria are

met: (1) there must be a "substantial" government interest that informs the regulatory scheme pursuant to which the inspection is made; (2) the warrantless inspections must be necessary to further the regulatory scheme; and (3) the statute's inspection scheme, in terms of the certainty and regularity of its application, must provide a constitutionally adequate substitute for a warrant. The Court then expanded on requirement number three as follows:

> In other words, the regulatory statute must perform the two basic functions of a warrant: it must advise the owner of the commercial premises that the search is being made pursuant to the law and has a properly defined scope, and it must limit the discretion of the inspecting officers. 107 S.Ct. at 2644 (emphasis added).

In summary, warrantless inspections necessary to further a vital public interest are permissible where the benefits to the public of the warrant process would be minimal because the inspection is made in the context of a regulatory inspection system of business premises which is carefully limited in time, place, and scope. The key to the warrantless search is the limitation of the discretion of the inspecting officers as to time, place and scope.

Constitutional Analysis – "As Applied"

There is little doubt that § 4083(c)[now (d)], together with the implementing regulations under Treas. Reg. § 48.4083 and the current administrative practices put in place either in the FCO Handbook or by the established routine procedures — all taken together — meet the criteria outlined in Colonnade, Biswell and Burger. However, a statute may be declared unconstitutional either on its face or as applied.

At the outset, we observe that your requesting memorandum quotes from a memorandum dated November 3, 2000 issued by the Assistant Chief Counsel, Collection, Bankruptcy and Summons [hereinafter CBS Memo] regarding the commercial trucking industry as a "pervasively regulated industry" for purposes of fuel inspection. Since the issuance of the CBS Memo, Chief Counsel has moved away from reliance on the trucking industry being heavily regulated and has focused entirely on the commercial use of fuel to serve as the "pervasively regulated industry" needed to permit warrantless entry and inspections.[1] It is the presence of fuel production or storage that permits an FCO to gain constitutional entry onto premises that have not been selected as a designated inspection site. § 4083(c)[now(d)](1)(A). Therefore, whether the commercial premises be a highway trucking company, an auto salvage yard, or a retail hay outlet, if fuel is or may be stored on the premises, then the FCO has a constitutional right to enter the premises and to inspect the storage tanks and whatever commercial

[1] In the near future a more detailed analysis of what is constitutionally needed to permit warrantless entry and inspections of fuel storage tanks and vehicles will be forthcoming. In the meantime, the status quo should be preserved and vehicles of 10,001 pounds or above should be the only vehicles subject to inspection.

motor vehicles are on the premises being inspected.[2]

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The inclusion of the propulsion tanks of commercial motor vehicles within the term "fuel storage facility that is not a terminal" could result in a court perceiving unfettered discretion on the part of the FCOs, which is anathema to the strict limitations set forth under Burger, as discussed above. For example, no matter where a commercial motor vehicle was parked, this would immediately open up the premises to entry by the FCO without a warrant to inspect that vehicle and any other qualifying vehicles on the premises. This interpretation would most probably be violative of the Burger requirement that the statute and regulations must advise the owner of commercial premises that the inspection is being made pursuant to the law which has a properly defined scope and which limits the discretion of inspecting officer. Thus, property owners who may not have anything to do with the fuel or trucking industry would then be subject to approach by an FCO by virtue of a commercial motor vehicle being parked there — for example, if the premises were a lumber yard, or a restaurant, or the premises of a business where office furniture was being delivered.

Moreover, this interpretation could be viewed as being tantamount to establishing a designated inspection site for one vehicle only — a practice that is not permitted under current policy precisely in order to meet the Burger criteria. It would promote randomness in inspection sites as what had become an inspection site at 11 a.m. because a truck had parked on that site, would no longer be an inspection site at noon if the truck departed. Inspection sites should have at least a quasi-permanence about them, in order to adequately inform the public that fuel inspections can take place there. Even designated inspections sites should stay open for the duration of several hours; otherwise, to set up a designated site for a few minutes could be seen as a ruse to arbitrarily attack a certain vehicle or driver.

A constitutional analysis of your narrower interpretation, "propulsion tanks on private property associated with the commercial trucking industry" yields no better results.

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[2] The current administrative practice regarding the term "fuel storage facility that is not a terminal" is to include fuel storage tanks on business premises as well as "skid" tanks on construction sites. The latter probably represents the outer definitional boundary of that term.

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An example could be a private tree-trimming company. This entity uses heavy trucks, but its property may not be "associated" with the commercial trucking industry. The only way that this argument could be countered would be to define "associated" as meaning "any incident of a commercial motor vehicle going onto the property." But this would result in bringing about the perception of unfettered discretion on the part of the FCO as was demonstrated above under the construct using just propulsion tanks as "fuel storage facilities."

We believe that either scenario would be constitutionally untenable. In our opinion, these scenarios do not provide an adequate substitute for a warrant in terms of the certainty and regularity of the application of the dyed fuel taxation regimen set forth in the statue and regulations. The scenarios do not clearly limit the discretion of the FCOs as to time, place and scope. To say that the fuel and storage tanks of the vehicle to be inspected also define the place where inspection is permitted not only would frustrate current procedures but also would not provide the clarity, predictability and specificity needed under Burger and progeny.

Plain Meaning and Legislative History

Your proposed interpretation could also be subject to attack as not comporting with the plain meaning of § 4083(d)[now (d)] and its underlying regulations. We first look to the legislative history of § 4083(c), Administrative Authority for guidance. The following passage is found in the Conference Report of the Committee On The Budget, House of Representatives, H.R. Conf. Rep. No. 103-213, at 664: "In addition, the conference agreement clarifies that Treasury has authority to physically inspect terminals, dyes and dyeing equipment and storage facilities, and downstream storage facilities; . . .. " This clearly serves as the referent authoritative source for Treas. Reg. § 48.4083-1(b), *Place of Inspection*, given that the statute itself does not define "place of inspection" in specific terms.

"Webster Online" as well as "Webster's Third New International Dictionary" defines "facility" as "something (as a hospital) that is built, constructed, installed or established to perform some particular function or to serve or facilitate some particular end." These same sources define "store" to mean "to place or leave in a location (as a warehouse, library, or computer memory) for preservation or later use or disposal."

Thus in the context of fuel taxation and in light of legislative history and the plain meaning of the words, the term *"fuel storage facility" can only indicate a permanent* place where fuel is held in bulk in order to serve the end of transporting and distributing the fuel in the stream of commerce. The propulsion tanks of a commercial motor vehicle hold only a small amount of fuel which serve only the particular purpose of the

vehicle in transporting its load or passengers.

Administrative Difficulties

The IRS has long taken the position that fuel delivered into the fuel tank of a vehicle or piece of equipment to serve as fuel for the operation of the vehicle or equipment becomes a component part of that vehicle or piece of equipment and loses its identity as a separate commodity.

Rev. Rul. 69-150, 1969-1 C.B. 286 held that gasoline sold in the United States by a producer and delivered into the propulsion tank of the automobile of the customer which was then immediately driven into Canada was not sold for export under the then extant manufacturer's excise tax exemption for the sale of an article for export. The fuel was not exported since it was a component part of the vehicle which was driven into Canada.

In Rev. Rul. 65-53, 1965-1 C.B. 542, a similar analysis was rendered. This ruling held that gasoline remaining in the fuel tank of a newly manufactured taxable vehicle when it is sold is considered to be a component part of a taxable article, thus allowing a credit for tax paid on the fuel to the manufacturer upon the sale of the vehicle.

Likewise, Rev. Rul. 59-294, 1959-1 C.B. 358, held that lubricating oil placed in an enclosed assembly or housing of a taxable article is considered as being a component material in the taxable article and hence would be free of tax on the oil.

The government asserted this position in Ammex, Inc. v. United States, 2002 WL 32065583 (E.D. Mich, July 31, 2002), reconsideration denied, 2002 WL 31777584, 90 A.F.T.R.2d, 2002-7330 (Oct. 22, 2002), under facts almost identical to Rev. Rul. 69-150. The court gave deference to the revenue ruling and held for the United States.

Finally, in TAM 200424021, the IRS asserted the position that fuel added to a vehicle becomes part of the vehicle and cannot be viewed as a separate commodity, citing Rev. Rul. 69-150. At issue was whether the cost to the customer of fuel purchased by an equipment rental company upon return of equipment by the customer without the fuel tank being refilled is a sale of fuel to the customer or a service fee. The IRS reasoned that since the fuel delivered into the tank of the equipment by the rental company became a component part of the equipment, title to the fuel never passed to the customer and therefore the extra cost paid by the customer upon return of the equipment to have the rental company fill the tank did not constitute a sale of fuel.

The proposed interpretation of Treas. Reg. § 48.4083-1(b)(1)(ii) as set forth in your requesting memorandum which would define the propulsion tanks of a commercial motor vehicle as a "fuel storage facility other than a terminal" would be directly antithetical to this long-standing position of the IRS. The fuel in the propulsion tanks is considered to be a constituent part of the vehicle, just as are the tires, the spark plugs,

and the drive shaft. Thus to consider the fuel to be "placed or left in a location (as a warehouse, library, or computer memory) for preservation or later use or disposal" would undercut the position articulated in Rev. Rul. 69-150.

Alternatives

Alternative methods of inspecting the propulsion tanks of commercial motor vehicles where fuel is not stored in bulk on the premises where the vehicles are located would include setting up a designated inspection site near the property where the vehicles are located or securing a writ of entry to inspect fuel. Also, in order to inspect vehicles which are not commercial motor vehicles (i.e., under 10,000 lbs GVW) a writ of entry would have to be secured in any event.

Division Counsel, SB/SE is always ready and willing to work with your FCOs and their managers in securing writs of entry. Our offices have processes in place for expediting writ requests. Our Pittsburgh office has developed standardized kits to fit every scenario which can be quickly utilized by any local SB/SE Counsel office, in liaison with a local U.S. Attorney's office, to quickly obtain a writ of entry.

In 2003 our Pittsburgh Office authored a 72-page script for an FCO IVT. The script covered all issues regarding warrantless searches, obtaining writs of entry, refusal penalties, and several other areas on which FCOs had indicated that they needed guidance. We would be most pleased to assist in developing an IVT on the subject should you decide to go forward with it.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions concerning the foregoing, please contact me at (202) 283-2452, or Associate Area Counsel Ed Peduzzi at (412) 644-3435.

Miriam A. Howe

for Thomas R. Thomas
Division Counsel
(Small Business/Self-Employed)